

# Urban RESEARCH Monitor

— Selected Housing Research

## Housing Markets and the Effects of the New Economy

### The State of the Nation's Housing 2002

*Joint Center for Housing Studies of  
Harvard University (2002)*

### New Economy Housing Markets: Fast and Furious – But Different?

*John D. Landis, Vicki Elmer, and Mathew  
Zook*

*Housing Policy Debate, Volume 13, Issue 2  
(2002)*

### Introduction

The housing market and the economy are linked in many ways. Residential investment, housing consumption, and related housing expenditures are critical to maintaining a strong economy. Sources of homeownership capital are integrated with other capital markets, and housing and rents have long been known to rise and fall with economic activity. For several years, home prices have outdistanced income—especially in places like

Boston, San Francisco, Washington, DC, and Manhattan. At the height of the economic boom of the 1990s, it was not uncommon to hear of two-bedroom cottages in Silicon Valley selling for \$800,000, or homes in Washington, DC selling as soon as they hit the market and commanding bids over the asking price. Lately, even as the economy has slowed, we still hear stories like these and the housing industry remains strong all across the country, raising new questions about the relationship between housing and the economy. Is the high cost of housing and the booming housing market simply a factor of economic growth or have changes in the economy's structure altered its relationship with housing markets?

This issue of URM looks at the current state of the housing market across the country and explores the dynamic between housing markets and the economy. The 2002 edition of "The State of the Nation's Housing", an annual publication from Harvard University's Joint Center for Housing Studies, provides a comprehensive understanding of the housing market and how it relates to overall economic conditions.

In the second piece, researchers from the University of California, Berkeley and the Public Policy Institute of California explore the housing markets in areas with new economies. The "new economy" refers to the significant restructuring in the economy over the past 25 years that is in part characterized by a rise in high-tech and knowledge-based industries, globalization among business, and most recently the growth of the Internet. Silicon Valley, Washington, DC and

Manhattan are centers of what is termed the new economy. The study, "New Economy Housing Markets: Fast and Furious—But Different?" demonstrates that the shift to the new economy has been found to fundamentally change the links between economic structure and housing outcomes. It is included in a themed edition of Housing Policy Debate that looks at how the economy of the 1980s and 1990s has affected land and housing markets. The study is among the first research to explicitly examine the links between the changing economy and the housing sector.

### Home Values Reach All-time High

Despite the economic recession and the events of September 11, the housing market has remained strong. Home sales, home spending, and home improvement are at all time highs. The State of the Nation's Housing report looks back at the housing market for 2001. It specifically addresses the relationship between housing and the economy, demographic drivers, homeownership, rental housing, and low-income housing needs.

The report illustrates that inflation-adjusted home prices in 2001 were up 5.7 percent over the previous year, continuing a seven-year trend of increasing prices. The aggregate value of homes in the U.S. topped \$12 trillion, setting a new high. The aggregate value of home equity also set records in 2001 as it increased more than eight percent over the value in 2000. The combination of low mortgage interest rates and housing equity also led many

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homeowners to refinance their homes, allowing them to pull cash out for other expenses or make home improvements. This unprecedented level of housing activity helped sustain consumer spending, which kept other segments of the economy afloat during the recent recession. The report advises that ongoing efforts to keep interest rates low and to promote the production of affordable housing are critical to sustaining the housing sector's contribution to the overall economy.

According to demographic trends, the report suggests that growth is predicted to continue over the next two decades in both the homeowner and rental markets. Increasing immigrant and minority populations will add households to both markets as will baby-boomer demand for vacation and retirement homes. However, the report cautions that if the new economy continues to drive housing price appreciation at such a rapid pace, an affordability gap may dampen predictions of market growth. In today's market, low mortgage interest rates have helped keep housing affordable in most areas, but when and if this changes many families may find homeownership more difficult to attain.

The homeownership rate rose to an all time high in 2001. Even so, the report describes a gap in homeownership rates between minorities and whites and concludes that it will persist in the years ahead if sub prime and predatory lending continue to go unchecked. Regulatory oversight has not kept pace with the changes in the mortgage lending industry. The report cautions that a growing number of low-income homeowners with little equity along with the high cost of mortgages for this group mean that homeownership gains may be undone and there could be damage to the overall housing market.

The report finds that affordability of rental housing remains a serious issue. In some areas of the country, a person who works full-time may still have trouble affording a modest two-bedroom apartment. While slowing at the national level, multifamily housing construction remained high in certain

areas with high immigrant populations. A major concern highlighted in the report is that a lack of access to mortgages and other financial resources is causing many small multi-family properties to deteriorate, putting them at risk of loss.

Despite the economic boom of the 1990s, the report proposes that housing conditions for the nation's 20 million lowest-income households has improved little. Many low-income working families pay more than half their incomes for housing. In addition, housing programs are ill-suited to the needs of elderly homeowners and renters despite the fact that they make up 42 percent of the nation's lowest-income families.

In looking ahead, the report cautions that even in the wake of growing affordability pressures, neither the Administration nor Congress project increased support for housing assistance and related social services over the next five years. In addition, states and localities are facing severe budget shortfalls of their own and so are likely to slash domestic programs. However, there is growing recognition that housing plays a prominent role in many public policy areas. For example, housing stability is seen as a key both to the well being of the lowest-income elderly and working families, and to the ability of welfare recipients to find and keep jobs. Housing is also increasingly an issue in the public health and safety arenas. The realization of the importance of the housing market to the well-being of the larger community, in combination with increasing sophistication of nonprofit housing providers and greater involvement of for-profit companies in the production and financing of affordable housing, is beginning to sound the wake up call. Both nonprofit organizations and for profit firms have called on Congress to increase federal housing assistance resources. The report emphasizes the importance of these groups in continuing to identify and support solutions to the nation's growing problem of affordable housing.

## Do Economic Trends Indicate a Changed Housing Market?

In "New Economy Housing Markets: Fast and Furious – But Different?" authors Landis, Elmer, and Zook explore further the boom in the housing market and the need to protect affordability. Their study is premised on the fact that while the economy has transformed into a high tech global economy, housing markets have remained local with markets differing from region to region far more than they ever have. The relationship between the transformation in the economy and the housing market has never before been systematically explored. The fact that housing markets follow economic trends is well known but the study explores whether the relationship is different in new economy markets.

The study looks at the economic structure of the 47 largest metropolitan statistical areas (MSAs) between 1993 and 1998 to see how they relate to housing outcomes. As an indicator of the new economy structure, the authors use a measurement of the number of dot-com firms in the MSA per thousand jobs. Three different types of housing outcomes are considered in the study:

- Price-related housing market activity and transactions.
- Housing welfare, including homeownership levels and overcrowding.
- Housing price and cost distribution within the MSA.

Regression analysis reveals how much the differences in housing outcomes are explained by the economic structure of each MSA, as opposed to housing supply and demand factors. Further analysis determines whether the factors are different in new versus old economies. The results show that while the new economy does affect housing outcomes, the supply and demand linkages that shape the housing market are not fundamentally changed. The new economy tends to "supercharge" the housing market, causing outcomes to take shape faster and be more extreme.

*Continues on Page 7, Column 1*

# New Research

## AFFORDABLE HOUSING

### **Housing Facts & Findings: Housing Supply and Affordability**

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#### **U.S. Department of Health and Human Services**

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#### **Virginia Center for Housing Research, Virginia Tech**

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(540) 231-3993  
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[www.arch.vt.edu/CAUS/RESEARCH/vchr/VCHR.html](http://www.arch.vt.edu/CAUS/RESEARCH/vchr/VCHR.html)

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*Continued from Page 2, Column 3*

The study finds that new economy markets are prone to higher housing prices and more overcrowding. However, rising income and employment seem to have the same effect on issues such as price and ownership rates as in old economies. Likewise, the positive effects of new housing production on ownership rates and affordability are much the same in old and new economies.

While housing prices may be higher, the distribution outcomes show that the new economy does not appear to directly affect levels of housing inequality within the MSAs. Housing inequality is more influenced by income. Housing values, housing costs, and housing rents are distributed more or less equally among both new and old economies. The study finds that within MSAs, the distribution of housing costs is slightly more equal in new economy markets, which is primarily an effect of higher incomes and job growth. Similarly, housing values and rent distributions in MSAs are also associated with income.

The authors conclude the study with several policy implications.

As a result of the finding that homes in the new economy areas are likely to be more expensive and more crowded, and that homeownership is more difficult to attain, the authors suggest that federal housing policies need to be more responsive to changes in local housing market conditions.

The study demonstrates that the industrial structure does not affect the distribution of outcomes within housing markets. The distribution of housing values, housing costs, and rents is neither more equal nor more unequal in new economy areas than in others. Income, rather than industrial structure, is the determinant of housing market conditions with higher incomes associated with more equal distribution of housing, values, costs, and rents. Based on these findings, the authors suggest that eligibility for federal housing assistance should continue to be based on income, rather than on place or product.

Supply does matter. The more responsive the home building industry and permitting process is to increases

in employment, the lower the median price of housing, rate of price appreciation, and housing price burden, and the higher the rate of homeownership. As a result, the authors suggest broadening long-term federal and state interest in reducing barriers to the construction of additional housing.

In conclusion, both of the articles highlight the importance of maintaining affordable housing. Despite the resilient housing market, housing affordability remains an issue for many people regardless of their geographic location. Low interest rates and sub prime lending practices targeted to the low-income population may be masking the magnitude of the affordability issue. Access to housing is still tied to income, and in areas where the new economy is stronger it is shown to be even more difficult to obtain affordable housing. Both pieces of research stress the need for new construction of affordable housing and urge developers (both for profit and nonprofit) and social service providers to advocate for an increase in the affordable housing stock and for policy makers to allocate additional resources.



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